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Remarks


 Executive Secretary
 27 Jul 87
 Date



**Comptroller General
of the United States**

Washington, D.C. 20548

Executive Registry

87-2822X

July 22, 1987

To Heads of Departments and Agencies

Ensuring successful implementation of the Federal Managers' Financial Integrity Act is one of my top priorities. To assist agencies in identifying their internal control and accounting system weaknesses, the President's Council on Management Improvement (PCMI) recommended that when General Accounting Office (GAO) audits identify significant problems, (1) a determination be made as to whether the problems are a result of internal control weaknesses and, if so, (2) the audit report contain a section commenting on the internal controls of the program, organization, or function audited.

Enclosed are copies of GAO Policy Bulletins No. 1 and No. 2 and GAO's "Guide for Incorporating Internal Control Evaluations Into GAO Work." The bulletins set forth GAO's policy for reviewing agency systems of internal control and reporting on internal control weaknesses identified through our normal audit process. The guide highlights evaluation and reporting steps that should be followed in GAO assignments.

Although these documents outline policies internal to GAO, we believe it is important that you be aware of actions we have taken to address the PCMI recommendations. The Financial Integrity Act provides a unique opportunity to highlight the need for effective internal control and accounting systems and can play an important role in improving overall federal financial management. We believe that the commitment and resources devoted to improving governmental internal control and accounting systems today will yield significant future benefits, including enhancing management's ability to do more with less.

We are also providing copies of these documents to the Director, Office of Management and Budget, the inspectors general, and the PCMI. If you have any questions or comments, please call Frederick D. Wolf, Director, Accounting and Financial Management Division, at (202) 275-9461 or Jeffrey C. Steinhoff, Associate Director, at (202) 275-9454.

Charles A. Bowsher

Charles A. Bowsher
Comptroller General
of the United States

DD/A REGISTRY
FILE: 60-7

Enclosures - 3

GAO POLICY BULLETIN NO. 1

**APPLICABILITY OF GENERALLY ACCEPTED GOVERNMENT
AUDITING STANDARDS TO VARIOUS TYPES OF GAO WORK
OTHER THAN FINANCIAL AUDITS**

**PURPOSE OF THIS
BULLETIN**

To promote greater consistency in the application of standards and policies on GAO audits and evaluations, this bulletin:

- Describes certain basic standards, derived from the Yellow Book, which must be followed on all GAO assignments.
- Recognizes the need for a case-by-case determination of the applicability of the remaining Yellow Book standards to each specific audit assignment. (Further guidance for determining the applicability of these standards will be provided in other bulletins in this series.)
- Emphasizes that conformity is required only for those Yellow Book standards applicable to a particular assignment.
- Provides examples of assignments for which the reports do not require a statement of conformity with Yellow Book standards.
- Summarizes key responsibilities for assuring compliance with applicable standards and for documenting decisions concerning the applicability of specific Yellow Book standards on individual GAO assignments.

This bulletin series is not intended to explain, modify or eliminate any standards, policies or requirements applicable to government audits of financial statements. In addition, nothing in the bulletins should be interpreted as eliminating the need to comply with Office policy requirements, such as referencing and obtaining agency comments, currently applicable to GAO's work.

**WHAT THE YELLOW
BOOK SAYS**

Reports on government audits shall include a statement that the audit was made in accordance with generally accepted government auditing standards.

A government auditor may be called upon to perform services for purposes other than audit. The Yellow

Book standards should be followed to the extent possible in performing these services.

**BASIC STANDARDS FOR
ALL GAO ASSIGNMENTS**

All GAO assignments will be conducted in accordance with the basic standards listed below. Although derived from the Yellow Book, these standards are designed to set the tone for the use of professional judgment by those involved in performing work on a wide variety of assignments.

Qualifications - Staff assigned to perform the work must collectively possess adequate professional proficiency for the task required.

Independence - In all matters relating to the work, the staff assigned must be free from personal or external impairments to independence and shall maintain an independent attitude and appearance.

Scope impairments - When factors external to GAO (such as denials of access to pertinent records) unreasonably restrict the scope of our work or interfere with our ability to form objective opinions and conclusions, an attempt should be made to remove the limitation or, failing that, the limitation will be reported.

Due professional care - Appropriate professional standards will be employed in performing all tasks to insure a high level of quality. In some cases, this requires conformity with standards of professions and disciplines other than auditing, such as the Evaluation Research Society Standards for Program Evaluation.

Planning - All work must be adequately planned to achieve assignment objectives efficiently and effectively.

Supervision - Staff must receive appropriate guidance in performing their work to insure high quality work and effective on-the-job training.

Evidence - Sufficient, competent, and relevant evidence must be obtained to satisfy assignment objectives and afford a reasonable basis for any judgments or conclusions reached. An adequate record of the work performed shall be prepared to demonstrate the correctness and reasonableness of any communication products.

Reporting - All communication products, both oral and written, shall be timely and shall present factual data accurately and fairly.

**WHEN A YELLOW
BOOK CONFORMITY
STATEMENT IS
REQUIRED**

If an assignment is undertaken to assess a government program's economy and efficiency of operations, effectiveness in achieving program results, or compliance with laws and regulations, the resulting report must include a statement of conformity with generally accepted government auditing standards. (See Chapter 2 of the General Policy Manual for details on the scope and objectives of GAO audits.) In addition to the eight basic standards described in the previous section, the Yellow Book has certain standards which are applicable to many, but not all, government audits. These are:

Field Work Standards:

- Internal control
- Computer-based systems
- Legal and regulatory requirements
- Fraud, abuse, and illegal acts

Reporting Standards:

- Form
- Distribution
- Contents
- Presentation

It is assumed that the conformity statement in a report refers only to those standards applicable to the particular assignment, and it need not be qualified to indicate that standards which were not applicable were not followed. The Associate Director must carefully consider the specific assignment objectives and decide whether these additional standards are applicable under the circumstances. Any deviation from an applicable Yellow Book standard must be clearly disclosed in the objectives, scope, and methodology section of the report together with an explanation of the deviation.

**WHEN A CONFORMITY
STATEMENT IS NOT
REQUIRED**

In line with its basic responsibilities for assisting the Congress by providing timely and reliable information for legislative and oversight purposes, GAO also performs important work which does not require a statement of conformity with the Yellow Book. For example, a statement of conformity is not required in reports on GAO assignments undertaken for purposes such as the following:

- To gather essentially factual information about a program.
- To assist a congressional requester by developing questions for use at hearings.
- To summarize or synthesize the results of previous work done by GAO or other organizations on a particular topic.
- To develop methods and approaches to be applied in evaluating a new or proposed program.
- To forecast potential program outcomes under various assumptions without evaluating current operations.

RESPONSIBILITIES

Associate Directors - The cognizant Associate Director (with support and assistance, as necessary, from management and staff in the participating headquarters and field offices) has the primary responsibility for seeing that each GAO assignment is conducted in accordance with applicable standards and GAO policies and requirements. The Associate Director is also responsible for deciding when a particular Yellow Book standard is not applicable on an individual audit assignment. An initial decision should be made during the scoping and planning phases of the assignment and recorded in the assignment plan or work program for the assignment's implementation phase. As the assignment progresses, the initial decisions concerning the applicability of the standards should be periodically reconsidered, and if necessary, the assignment plan should be modified.

REFERENCES

Standards for Audit of Governmental Organizations, Programs, Activities, and Functions, U.S. General Accounting Office (Yellow Book).

Chapter 2 of the General Policy Manual—Basic Audit Objectives and Policies.

Chapter 3 of the General Policy Manual—Auditing Standards.

Standards for Evaluation Practice, Evaluation Research Society, Peter H. Rossi, Editor.

GAO POLICY BULLETIN NO. 2

**STANDARDS AND POLICIES FOR EVALUATING AND
REPORTING ON INTERNAL CONTROL SYSTEMS**

**PURPOSE OF THIS
BULLETIN**

Policy Bulletin No. 1 describes eight basic standards that must be followed on all GAO assignments. The Yellow Book standards for internal control studies are not included in those basic standards, but are applicable to many GAO assignments. This bulletin provides general guidance for determining when the internal control standards apply and the scope and nature of the work required for conformity on assignments other than financial audits.

**WHAT THE YELLOW
BOOK SAYS**

1. During a government economy and efficiency audit or a program results audit, a study and evaluation shall be made of the internal control system applicable to the organization, program, activity, or function under audit.
2. The audit report should include a description of material weaknesses found in the internal control system.

DEFINITIONS

Internal control is the plan of organization and methods and procedures, including internal audit, used by management to achieve the objectives of programs or functions. It helps ensure that

1. resource use is consistent with laws, regulations, and policies;
2. resources are safeguarded against waste, loss, and misuse; and
3. reliable data are obtained, maintained, and fairly disclosed in reports.

Internal controls include

1. administrative (management) controls, which are concerned with management's decisionmaking process for reasonably assuring that its operations are carried out in an efficient and economical manner and in accordance with managerial policies, goals, and objectives, and

2. **accounting controls**, which are primarily concerned with the safeguarding of assets and the reliability of financial records.

Internal control weaknesses are conditions in which the specific control procedures, or the degree of compliance with them, are not sufficient to achieve a specific control objective--that is, errors or irregularities may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

APPLICABILITY

The Yellow Book internal control standards will be considered applicable to each GAO assignment which meets the criteria in Policy Bulletin No. 1 for a statement of conformity with generally accepted government auditing standards, except for certain limited-scope assignments where the objectives clearly do not focus on internal management responsibilities.

The nature, extent, and scope of the work necessary for conformity with the internal control standards will vary considerably depending on the particular assignment objectives. Where assignment objectives include determining the cause of management problems/deficiencies and making recommendations thereon, conformity with the internal control standards requires a study and evaluation of relevant controls and the reporting of any material weaknesses noted. This work should provide a basis for

1. determining whether such controls are capable of reasonably assuring that material errors and irregularities are avoided and whether the prescribed controls have been maintained and are operating effectively;
2. determining the nature, extent, and timing of tests and other procedures to be applied in accomplishing the audit objectives; and
3. identifying and developing the causes for management problems or deficiencies and making constructive recommendations to correct them.

Where the assignment objectives involve gathering and analyzing information about program impact without attempting to assess how well the agency discharged any of its managerial responsibilities, no evaluation of internal controls is necessary. However, even on assignments where the standards are not applicable, it may be necessary and appropriate

to obtain information about certain internal controls and to test the adequacy of those controls to ensure the reliability of the data being used.

PLANNING AND SCOPING ISSUES

Planning considerations

In planning each GAO audit assignment, specific consideration must be given to obtaining knowledge and understanding of the organization, program, function, or activity being reviewed and any relevant internal controls. This information is crucial for making decisions on what specific work must be performed during the implementation phase of an assignment to efficiently and effectively achieve assignment objectives.

In planning assignments, we should take into account pertinent work already done by GAO, internal auditors, and other study groups and consider its reliability and usefulness in achieving our objectives. In this regard, the agencies' internal control assessments and annual reports made in accordance with the Federal Managers' Financial Integrity Act may provide an especially useful source of information on controls. Access to this material can be arranged through each division's representative on GAO's Financial Integrity Act Steering Committee.

Scoping assignments that include internal controls

The scope of the study and evaluation of internal controls on a particular assignment is a matter of judgment taking into account the procedures necessary to satisfy assignment objectives and the time and effort required to perform the procedures.

A review of all internal controls of an agency, as part of a specific assignment, would usually be prohibitive in terms of our available time and resources. We should, therefore, concentrate on those particular controls which are important to accomplishing the assignment objectives.

To save time and conserve our limited resources, we should rely to the maximum extent possible on control mechanisms already established within an agency, including the various arrangements made by management for internal audits and other forms of inspection, appraisal, and evaluation. If warranted, we will assess the reliability of such work and make full use of it in conducting our work.

In some cases, we may decide that it is more efficient to expand our testing of details and apply analytical procedures than to make a study and evaluation of internal controls. This may occur when we conclude that the effort required to study and evaluate the controls exceeds the reduction in audit effort that could be achieved by relying on them. Such a conclusion may result from (1) the nature or limited amount of information available for examination; (2) the data processing methods used; and (3) the procedures that can be applied in making detailed tests. We should then design detailed tests that do not contemplate reliance on internal controls.

In other cases, the internal control system may contain so many weaknesses that we have no choice but to perform detailed tests and analytical procedures. For example, if control procedures are not suitably designed for us to rely on them for assignment purposes, we should not test compliance with those controls. Instead, we should design detailed tests that do not contemplate reliance on such internal controls.

Where the assignment objectives include determining the causes of problems or deficiencies, we should determine whether the problems or deficiencies resulted from material internal control weaknesses and, if so, develop appropriate recommendations for corrective action.

REPORTING ISSUES

Fairly reporting what we did and did not do

Our reports must clearly describe the objectives and scope of our work to avoid any misunderstanding by our readers concerning what we did or did not do on internal controls and the extent to which we relied on the internal control system.

Explaining deviations from the Yellow Book

When internal controls are important to the issues being addressed in an audit report, but we have not reviewed them, the statement in the report concerning conformity with the Yellow Book standards must be qualified and the reasons therefore disclosed. For example:

"We did not review internal controls relating to the accuracy of stock balances on hand, which are discussed in chapter 3 of this report, because...(cite reason). Except as noted above, our work was conducted in accordance with generally accepted government auditing standards."

If internal controls were not reviewed because (1) they were not important to the issues or (2) expanded testing of detailed records and application of analytical procedures was done instead, this should not be considered a deviation and the statement in the report concerning conformity with the Yellow Book standards should not be qualified.

Disclosing control weaknesses

If significant deficiencies or problems resulted from internal control weaknesses, the weaknesses should be discussed in the report and linked, as specifically as possible, to GAO's Standards for Internal Controls in the Federal Government. Material internal control weaknesses identified in our work typically are presented as causes of problems or deficiencies with appropriate recommendations for corrective action. By explicitly relating deficiencies and problems to internal control weaknesses in our reports, we can improve the utility and effectiveness of our work in stimulating corrective actions. If material internal control weaknesses are identified, our report should also disclose whether or not these weaknesses were included in the agency's reporting under the Federal Manager's Financial Integrity Act. This will make our reports more useful to GAO and other audit groups in subsequent work done under the act.

RESPONSIBILITIES

The cognizant Associate Director is primarily responsible for deciding when the Yellow Book standards concerning internal control systems are applicable to a specific GAO assignment and for approving and documenting all decisions concerning the scope and reporting of internal control studies.

REFERENCES

Standards for Audit of Governmental Organizations, Programs, Activities, and Functions, U.S. General Accounting Office (Yellow Book).

Chapter 2 of the General Policy Manual--Basic Audit Objectives and Policies.

Chapter 3 of the General Policy Manual--Auditing Standards (includes Policy Bulletin No. 1). Chapter 8 of the General Policy Manual--Agency Management Control.

Standards for Internal Controls in the Federal Government, GAO Policies and Procedures Manual for Guidance of Federal Agencies, Title 2, Appendix II.

CARE-Based Audit Methodology To Review And Evaluate
Agency Accounting And Financial Management Systems,
U.S. General Accounting Office.

Federal Managers' Financial Integrity Act of 1982,
Public Law 97-255.

Internal Control Systems, OMB Circular No. A-123,
Revised.

United States General Accounting Office

GAO

March 1987

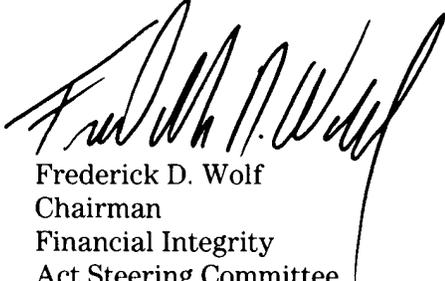
Guide for Incorporating Internal Control Evaluations Into GAO Work

Preface

This guide is to help implement GAO's current policy (contained in Policy Bulletin No. 2, pp. 3-15 to 3-20 of the General Policy Manual) for evaluating and reporting on agency internal control systems. It recognizes that, although Associate Directors now decide how individual assignments will address internal controls, other individuals and groups throughout GAO have important responsibilities that influence how well those assignments are carried out.

The guide emphasizes that internal controls are integral to all agency operations and highlights evaluation steps that should be followed in the planning/scoping phases of most GAO assignments. It provides guidance on when an assignment should include a comprehensive evaluation of internal controls or when a more limited evaluation, referred to in the guide as a "targeted approach," is appropriate. It also discusses the basic steps for carrying out and reporting on results of both types of evaluations as well as the responsibilities of key GAO players in the internal control area.

The guide should be filed behind Policy Bulletin No. 2 in the General Policy Manual.



Frederick D. Wolf
Chairman
Financial Integrity
Act Steering Committee



Werner Grosshans
Director
Office of Policy

March 1987

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Abbreviations

DEA	Drug Enforcement Administration
FIA	Federal Managers' Financial Integrity Act of 1982
GAO	General Accounting Office

Guide for Incorporating Internal Control Evaluations Into GAO Work

Introduction

Policy Bulletin No. 2, issued in February 1986, reaffirms GAO's commitment to previously issued internal control standards and assigns to Associate Directors the primary responsibility for ensuring that our work adequately considers internal controls.

In 1972, GAO issued (and in 1981 revised) Standards for Audit of Governmental Organizations, Programs, Activities, and Functions—commonly referred to as the Yellow Book. The Yellow Book provides that, during a government audit, an evaluation shall be made of the internal control system applicable to the organization, program, activity, or function under audit. This evaluation should assess whether the internal controls can be relied on to ensure compliance with applicable laws and regulations and whether the entity is managing or using its resources effectively and efficiently. It is common practice in some audits, and consistent with Yellow Book standards, to identify problem areas first and then review management controls that relate to the area in which the problem exists.

GAO issued Standards for Internal Controls in the Federal Government in 1983, as required by the Federal Managers' Financial Integrity Act of 1982 (FIA). These broad standards, commonly referred to as the Green Book, are to be used by agency managers in establishing effective internal control systems and in reporting on the overall status of their systems.

This guide helps implement Policy Bulletin No. 2 by outlining practical steps GAO staff can take to evaluate internal controls using the concepts set forth in the three policy documents noted above.

Evaluating Internal Controls

This section provides general guidance on how to evaluate internal controls. It begins by discussing what internal controls are and emphasizing that they are integral to all agency operations, not just the financial or administrative areas. Next, it highlights several important review steps that should be followed in the planning/scoping phases of an assignment. It concludes with a detailed discussion of two approaches for conducting internal control evaluations during assignment implementation—a “comprehensive” approach and a “targeted” approach. Consistent with Policy Bulletin No. 2, the nature, scope, objectives, and timing of GAO evaluations should be used to determine which of these approaches is more appropriate for a specific assignment. However, because much of GAO's work is directed to identifying problem

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areas, it is anticipated that the targeted approach (which restricts internal control evaluation to specific findings or problem areas) would be used most of the time.

**What Are Internal
Controls?**

Internal controls are the combination of management objectives (policies) and techniques (procedures) used by managers to help ensure that their agencies, programs, or functions are effectively and efficiently managed in conformity with applicable laws and regulations. Obtaining an understanding of an agency's internal control systems relating to a program or activity under review should be a key concern during most GAO assignments.

Essentially, control objectives are the positive things agency managers want to have happen or negative things they want to prevent from happening. Control objectives address the risks inherent in the work being done. Control techniques are the procedures managers use to provide reasonable assurance that their control objectives are achieved—that is, to accomplish the positive things and prevent the negative things from happening.

Effective internal controls help ensure that (1) funds are used, and activities are conducted, consistent with laws, regulations, and policies; (2) resources are safeguarded against waste, loss, and misuse; (3) programs and activities are efficiently and effectively carried out; and (4) reliable data are obtained, maintained, and fairly disclosed in reports. Administrative, management, and accounting controls are all part of an agency's internal control system. Internal controls often include such commonsense actions as

- verifying earnings of families on a test basis to ensure only eligible families receive food stamps;
- ensuring proper security is maintained over seized property; and
- making sure that physical inventories are not conducted by the same persons who are responsible for maintaining inventory records.

The Green Book should be a helpful reference in all GAO audits (except for those limited-scope assignments described in Policy Bulletin No. 2, where our objectives clearly do not focus on internal management responsibilities). The Green Book contains 12 standards—5 general, 6 specific, and an audit resolution standard. The Green Book standards are very broad, and professional judgment must be used in determining

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whether they have been adequately met in specific situations. The five general standards provide that:

- Internal control systems are to provide reasonable assurance that management's objectives will be accomplished.
- Managers and employees are to maintain and demonstrate positive and supportive attitudes toward internal controls at all times.
- Managers and employees are to have personal and professional integrity and maintain a level of competence that allows them to accomplish their assigned duties, as well as understand the importance of developing and implementing good internal controls.
- Internal control objectives are to be developed for each agency activity and are to be logical, applicable, and reasonably complete.
- Internal control techniques are to be effective and efficient in accomplishing internal control objectives.

A number of specific internal control techniques can be used to provide assurance that the general internal control standards are achieved. GAO's six specific internal control standards classify the wide variety of different techniques that may be used to achieve control objectives. In abbreviated form, the six standards require that:

- Transactions and other significant events must be documented.
- Transactions and other significant events must be recorded promptly.
- Transactions and other significant events must be authorized and executed by persons acting within their authority.
- Key duties must be separated among individuals.
- Qualified and continuous supervision must be provided to ensure that internal control objectives are achieved.
- Access to resources and records must be limited and accountability for custody must be assigned with periodic comparisons of the resources with the recorded accountability.

The audit resolution standard requires that managers promptly evaluate and take action on findings and recommendations reported by auditors.

Consideration of Internal Controls in Planning/ Scoping

During the planning/scoping phase of all GAO audits, evaluators should use agencies' internal control evaluations and annual FIA reports to the President and the Congress. Agencies' reports and supporting documentation can help develop an understanding of acknowledged weaknesses (and progress in correcting weaknesses) in the area being reviewed.

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Therefore, all audits—financial, economy and efficiency, and program results—should, at a minimum, include the following steps:

1. Review agency's latest FIA report to determine whether issues were reported that could affect the scope or objectives of the audit.
2. Discuss with division's FIA team whether they have any knowledge of agency internal control weaknesses not disclosed in the agency's FIA report that might affect the audit.
3. Determine from agency officials and obtain any reports related to
 - whether the activity, program, operation, or function under review was evaluated under FIA and what the results were;
 - whether control objectives and techniques are established for the area under review and whether the control techniques were tested to ensure they work as intended; and
 - the perceptions of agency officials on the adequacy of the control environment (objectives and techniques) for the area under audit.

The results of the above steps should be considered in determining whether the comprehensive or targeted approach to evaluating internal controls should be used during the implementation phase. While many GAO assignments are not specifically directed at the issue of internal controls, weak or nonexistent controls should be explicitly considered because they can be one of the underlying causes of problems GAO finds. The targeted approach is tailored to these situations.

Comprehensive Approach to Evaluating Internal Controls

The "comprehensive approach" calls for the evaluator to determine the relative risks associated with the entire internal control system of the agency, program, or function being reviewed. Using this approach, the evaluator determines whether adequate control measures exist and are working. This comprehensive approach should be used if the primary objective of the work is to evaluate the internal controls of a particular area. There is no presumption that the evaluator is already aware of a problem or finding in the area.

Consistent with GAO's Green Book, there are generally six steps involved in evaluating internal controls using this comprehensive approach:

1. Identifying groups of related activities within the agency, program, or function being reviewed.

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2. Gaining an understanding of how these groups of related activities operate and interrelate.
3. Evaluating internal controls for the groups of related activities. (Identifying key risks, determining control objectives, and seeing if management has implemented techniques to achieve those objectives.)
4. Testing the existence and adequacy of controls for the groupings of related activities and whether they are being followed.
5. Determining appropriate corrective actions to fix weak controls.
6. Assessing risks associated with the general control environment (considering such factors as the size of budget, organizational structure, and prior evaluations).

It is important to note that under the comprehensive approach, the internal control weaknesses represent the cause of a problem or adverse effect yet to be found. If agency management is convinced of the need to implement corrective actions based on identification of control weaknesses, it may be appropriate to terminate review work and finalize a report. However, significant internal control deficiencies in an area where management does not agree that corrective action is needed may warrant more extensive testing to determine dollars lost or fraud, waste, or abuse that has occurred as a result of the weakness (i.e., the problem or adverse effect). For example, the legislation authorizing a federal loan or grant program may contain eligibility requirements governing program participation. If the evaluator concludes that the agency has serious deficiencies in controls over determining and monitoring eligibility and the agency does not concur, the evaluator may need to do more work to determine the extent to which ineligible participants are in the program—in other words, establish the bad effect.

**Targeted Approach to
Evaluating Internal
Controls**

The “targeted approach” essentially calls for evaluators to better integrate internal control evaluations into the criteria, condition, cause, and effect development of individual findings and recommendations. This approach would be used once a problem has been identified. The agency’s control objectives and Comptroller General standards represent criteria that GAO staff should use to link identified problems (condition/effect) to their cause. Often, control techniques are a principal cause of the problems because they are inadequate or not complied with.

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The criteria, condition, cause, and effect elements of a finding are the building blocks of sound recommendations and effective GAO reports. Determining how the relevant control techniques operated relative to the identified problem (condition/effect) should help identify underlying causes of the problem and more effectively facilitate agency corrective action. The underlying cause of a problem is often the failure to follow internal control techniques that have been established to achieve a desired result. In other situations, the cause may be poor internal control techniques or the lack of techniques.

Four basic steps are involved in evaluating internal controls using the targeted approach:

1. Identifying internal control objectives (policies) that management has designed to ensure that an observed adverse condition/negative effect does not occur.
2. Identifying key internal control techniques (procedures) that management has established to achieve the above objectives.
3. Testing operating procedures to determine their effectiveness in preventing the observed adverse condition/negative effect from occurring.
4. Identifying any needed adjustments to management's existing objectives or techniques.

For illustrative purposes, the following narrative briefly describes how these four steps might be applied in the context of a GAO audit of the Drug Enforcement Administration's (DEA) seized property program (Drug Enforcement Administration's Use of Forfeited Personal Property, GAO/GGD-87-20, Dec. 10, 1986). In this case, GAO identified an adverse condition, specifically that government agents were inappropriately using seized property. The work already done demonstrated that the use of the property was not consistent with agency policy (control objectives).

The four-step targeted approach might then be applied as follows:

1. The internal control objective relative to this adverse condition was that seized property should be converted to official government use only when appropriate.

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2. GAO identified the following internal control techniques (procedures) that were established for seized property:

- All seized property must be accounted for when received and entered into the inventory records on a timely basis.
- All seized property must be periodically inventoried and these inventories reconciled with official inventory records.

3. By examining the forms used to authorize the use of seized property for official government use, GAO determined that the conversions were not properly justified or reviewed by someone independent of the special agent. (This is not consistent with GAO's fourth specific internal control standard calling for separation of key duties.)

4. DEA implemented GAO's suggestions for strengthening internal controls by issuing instructions for converting forfeited property to government use. The instructions require field managers to provide written justification for the need and use of forfeited property that they desire to convert to government use and to obtain headquarters approval before the property is placed into service. Periodic rejustifications could also help ensure there is a continuing need for particularly valuable property.

This targeted approach should help ensure that adverse conditions/negative effects identified during GAO's work are better linked to internal control weaknesses, if they are determined to be the cause, and help facilitate agency acceptance of GAO recommendations.

Reporting on Internal Controls

While Policy Bulletin No. 2 provides guidance, it also allows a considerable amount of flexibility in reporting on the results of GAO's internal control evaluations. The Bulletin prescribes that GAO reports should include a statement on the extent to which internal controls were examined during the review and the extent to which reliance was placed on agency internal controls. It also requires that if material internal control weaknesses are identified, GAO should disclose whether these weaknesses were included in the agency's year-end report under FIA and, if not, why not.

While the Green Book presents standards or principles to be used by managers in setting up internal control procedures, they are general and do not, by themselves, provide sufficiently detailed criteria for determining whether internal controls are effective. Therefore, in reporting on the results of GAO's internal control work, evaluators should comment

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on the adequacy or inadequacy of specific control techniques (such as separation of duties) used by an agency to accomplish a particular control objective (such as protection of property from theft). However, whether it is appropriate to cite inconsistencies with specific Green Book standards should be determined on a case-by-case basis, taking into consideration the objectives and scope of the review as well as the extent of available evidence.

GAO's report on DEA's seized property program, discussed previously, included the following:

- The objectives, scope, and methodology section stated that:

"Our objective was to evaluate the adequacy of controls governing DEA's conversion of forfeited personal property to official government use. Specifically, we determined whether the Dallas field division office had adhered to DEA policies and procedures in converting forfeited personal property to government use. We did not review all property that had been converted because DEA headquarters officials believed that the Dallas situation illustrated the need for clarification and/or changes of DEA's policy and procedures."

- As part of the discussion of the finding, GAO reported that the seized property conversion decisions were not reviewed by someone independent of the special agent. In this case, the lack of independent review was a cause of the problem, and the report was developed along those lines. The report also stated that the agency's controls were deficient relative to internal control standards established by the Green Book. This disclosure was in harmony with the review objectives, and sufficient evidence was available to draw such a broad conclusion.

Roles and Responsibilities

Policy Bulletin No. 2 clearly recognizes the central role played by cognizant Associate Directors in deciding whether and how individual GAO assignments will address internal controls. However, many other individuals and groups also have important roles and responsibilities. GAO staff involved in program issue areas, as well as FIA staff, need to be involved if the objective of Policy Bulletin No. 2—Evaluating and Improving Internal Controls—is to be more effectively integrated into our work.

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**Associate Directors, Group
Directors, and Evaluators-
in-Charge**

Associate Directors, supported by Group Directors and Evaluators-in-Charge, should decide whether, consistent with Policy Bulletin No. 2, an evaluation of internal controls applies to a specific assignment. They should also decide on the most appropriate methodology for evaluating and the most appropriate approach for reporting on internal controls. Also, decisions on the scope of internal control evaluations and on the reporting of internal control issues should be appropriately documented for future reference.

The primary responsibility for ensuring that available FIA-related information is adequately considered in the planning/scoping phase of each assignment rests with GAO's Associate Directors. As a minimum, for each assignment, they should ensure that:

1. The agency's latest FIA report is reviewed to determine whether it discloses any pertinent material weaknesses.
2. The objectives and scope of the assignment are discussed with the cognizant FIA team to determine whether there are any weaknesses, not disclosed in the agency's FIA report, that should be considered.
3. The results of any FIA evaluations within the areas covered by the assignment are identified. This can be done through discussions with agency officials or the review of FIA reports or other documentation. Specifically, the Associate Director or his staff should (1) determine whether control objectives and techniques have been established and tested for the activity or program being evaluated and, if established, (2) assess the overall adequacy of these objectives and techniques.
4. The work needed to determine whether an observed problem was caused by an underlying internal control weakness is conducted.
5. An appropriate reporting approach is followed with respect to internal control weaknesses for both the objectives, scope, and methodology section and the findings section of GAO reports.

**Headquarters and Field
Office Heads**

The need for reviewing and reporting on internal controls should be integrated in GAO's planning and individual assignment management process. As part of the review of job decision packages and review guidelines (Firm Assignment Lists, Forms 100, etc.), division and regional management should ensure that adequate consideration is given

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to the question of whether and how internal controls should be evaluated. Also, they should ensure that staff receive appropriate training and supervision for evaluating and reporting on internal controls.

FIA Steering Committee

Members of the FIA Steering Committee and their staffs are available to work with program audit groups to help decide how best to incorporate internal control evaluations in their assignments. This should be of particular help to the program audit groups for those evaluations where the principal focus of the work is not internal controls but where weak internal controls may be the cause of a problem GAO has identified. Specifically, the FIA teams are available to assist in the following areas:

- Obtaining information on (1) internal control weaknesses identified by the agencies in their FIA and other agency efforts and (2) the status and adequacy of related corrective actions.
- Planning the scope of internal control evaluation work that should be included in specific assignments.
- Determining the amount and type of testing needed to determine if an observed problem was caused by an underlying internal control weakness. When internal control weaknesses are identified, the FIA teams can help determine if additional development of the internal control weakness is warranted.
- Developing report language for the scope of internal control work and the results of internal control evaluations.

Through these specific actions, the FIA teams can help the Associate Directors provide the focus on internal controls that will be needed to meet the Comptroller General's expressed goal of providing GAO with a basis for keeping the Congress informed on the progress being made in improving the government's internal control systems and encouraging agency managers to strengthen those systems.

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